Calendar No. 1011

101ST CONGRESS *2d Session*	SENATE	REPORT 101-549

RESOLUTION TRUST CORPORATION FUNDING ACT OF 1990

REPORT

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

TO ACCOMPANY

S. 3222

together with

ADDITIONAL VIEWS

OCTOBER 19 (legislative day, OCTOBER 2), 1990.—Ordered to be printed

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OCTOBER 19 (legislative day, OCTOBER 2), 1990.—Ordered to be printed

Mr. RIEGLE, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

REPORT

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ADDITIONAL VIEWS

[To accompany S. 3222]

INTRODUCTION

On October 12, 1990, the Committee on Banking, Housing, and Urban Affairs marked up and ordered to be reported an original bill, the Resolution Trust Corporation Funding Act of 1990, to amend the Federal Home Loan Bank Act to enable the Resolution Trust Corporation (RTC) to meet its obligations to depositors and others by the least expensive means.

SUMMARY OF PROVISIONS

The Resolution Trust Corporation Funding Act of 1990 has two major purposes. First, the Act provides $57 billion to the RTC so that it can continue its statutory task of protecting the insured depositors of failed savings and loan institutions. The Committee is advised that this amount will suffice through fiscal year 1991.

Second, the Act provides necessary funding to permit the RTC to exercise options and otherwise modify, renegotiate, or restructure assistance agreements entered into during 1988 and early 1989 by the Federal Savings and Loan Insurance Corporation (FSLIC) with acquirers of failed thrifts. The Act permits the RTC to expend these funds only upon a determination by the Oversight Board of

49-010

the RTC that such expenditures will yield net economic savings over time.

RTC FUNDING FOR CURRENT CASE RESOLUTIONS

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) established the RTC to protect insured depositors of thrifts failing during the 3-year period beginning August 9, 1989. To accomplish this purpose, FIRREA gave the RTC long-term financing of $50 billion—an amount requested by the Administration. Of that sum, Treasury appropriations comprised $18.8 billion, Federal Home Loan Bank contributions $1.2 billion, and borrowings through a new, off-budget agency—the Resolution Funding Corporation (REFCORP)—$30 billion. FIRREA also permitted the RTC to borrow money for temporary acquisition of assets from thrifts under its control, but limited such borrowings to the sum of the unused portion of the $50 billion of long-term financing, cash on hand, and 85 percent of other acquired assets.

The inadequacy of the RTC's funding became apparent within a few months after FIRREA's enactment. In the Spring of 1990, both the General Accounting Office and the Congressional Budget Office prepared analyses tending to show that the RTC lacked sufficient funds to accomplish its statutory responsibilities. On May 23, 1990, Secretary Brady told the Banking Committee that "[i]t is now clear that the amounts projected and authorized for the RTC in FIRREA will fall short of what is required." [1] Secretary Brady indicated that the RTC would need some $39–82 billion in addition to amounts provided by FIRREA—an upward revision of 124–230 percent. Secretary Brady explained that the Administration's original projections had underestimated the extent of losses in the individual failed savings and loans. In addition, he indicated that the Administration had revised its projection of the RTC's caseload from 500 institutions to a range of 722–1037 institutions.

In his testimony, Secretary Brady cited five factors that contributed to the sharp change in expectations:

> The first is a general decline in regional real estate markets, particularly commercial real estate. This has been true not only in the southwest, but in the northeast, southeast, and other parts of the country. Unfortunately, thrift assets are heavily concentrated in real estate whether through direct investments, foreclosed property, or real estate loans. FIRREA sharply curtailed the amount of commercial real estate activities that thrifts can engage in going forward, but obviously, it could not address the losses already embedded in troubled thrifts.
>
> A related concern involves the institutions that we expected would be the primary purchasers of thrift deposits and thrift assets—other depository institutions. It's no secret that health banks and thrifts have become much more leery about taking real estate assets onto their bal-

[1] Statement of Secretary Nicholas F. Brady on behalf of the Oversight Board of the Resolution Trust Corporation before the Senate Committee on Banking, Housing, and Urban Affairs, May 23, 1990 (typescript), p. 13.

ance sheets in view of current market conditions. Unfortunately, that is exactly what the RTC is trying to sell to them. The result has been few "whole thrift" transactions, where both good and bad assets pass to an acquirer, and a few transactions where the acquirer takes *any* bad assets. This means more bad assets piling up at the RTC with lower expectations of the ultimate revenues they will produce.

A third factor is interest rates, which are now higher than we had projected. That translates directly into increased operating losses for thrifts in conservatorships and indirectly into softer real estate markets, since interest rates always play a key role in that sector of the economy.

A fourth factor is unexpected losses in below-investment grade bonds, sometimes referred to as "high yield" or "junk" bonds. As you know, FIRREA required thrifts both to divest these bonds and to carry them on their books at market value. The market for these bonds has dropped off substantially in recent months, and virtually all of the major thrift holders of these bonds have been taken over by the RTC. The result is that the RTC is now one of the largest owners of junk bonds, with some $4 billion in its portfolio, and it could end up with substantially more. At the same time, we just don't know exactly how much these bonds will be worth when they are finally sold.

A fifth factor is that, at least for some purchasers, thrifts just are not as attractive a franchise relative to banks as they once were. This is true in part because it is no longer possible either to run a thrift with low capital or to invest insured deposits in risky activities like direct real estate investment. That is as it should be, since it was activities like these that helped cause the problem.

But other restrictions imposed by FIRREA that are unrelated to safety and soundness, like the tighter qualified thrift lender test, may have also reduced the value of the thrift charter. However, it is too soon to say by how much.[2]

On July 31, 1990, Secretary Brady advised Chairman Riegle that "it will be necessary for the Congress to take some action before adjourning for the year," and suggested three funding alternatives that would be acceptable to the Administration. Under Secretary of the Treasury Robert Glauber reiterated this concern in testimony before the Banking Committee on September 26. On October 10, 1990, in a letter to members of both the Senate and House Banking Committees, Secretary Brady warned that "RTC case resolution will virtually cease within the next two months unless additional funds are provided." [3] On behalf of the Administration, he requested legislation to provide funding through the end of the current fiscal year. Secretary Brady asked that Congress provide the RTC with additional, long-term financing of $40 billion and remove limi-

[2] Ibid.
[3] These letters are contained in the appendix to this report.

tations placed by FIRREA on the RTC's borrowing. He further indicated that, if Congress elected not to remove those limitations, the RTC would need an additional $17 billion—or a total of $57 billion.

The Committee believes the basis for the Administration's request for additional funds is clear and sound. On October 15, 1990, the RTC had resolved 290 thrifts and spent $83.6 billion as follows: [4]

	Billions
Losses on Insurance obligations to depositors	$33.4
Acquisition of thrift assets for resale	40.9
Temporary advances to conservatorships	8.4
Administrative expenses	.1
Interest on borrowings from the Federal Financing Bank	.9
Total	83.6

Of the total, $49.2 billion comprises expenditures of working capital to fund acquisition of savings and loan assets for resale ($40.9 billion) and advances to conservatorships ($8.4 billion). The remaining $34.4 billion represents permanent losses, of which $33.4 consists of losses on insurance obligations to depositors.

The RTC's $83.6 billion in expenditures through October 15 derived from two sources, both of which it has nearly depleted. Of the $83.6 billion, $42.1 billion came out of the $50 billion FIRREA provided for permanent loss financing. The remaining $41.5 billion consisted of working capital borrowings from the Federal Financing Bank, an agency of the Treasury. The RTC retained $8 billion in permanent borrowing authority—an amount it will soon exhaust at its present rate of activity. Indeed, the RTC could spend much of its remaining permanent loss funds simply by proceeding to close savings and loans originally scheduled for resolution in the third quarter of FY 1990.

The precise value of the RTC's assets is uncertain, especially in view of the poor condition of many of the assets in its portfolio and the current slump in real estate markets throughout the United States. For that reason, FIRREA limited the RTC's working capital borrowings to the sum of 85 percent of its assets and unused permanent funds. The RTC is rapidly approaching that limit as it spends its remaining permanent funds.

The task remaining before the RTC is formidable. As of October 1, 207 thrifts, with assets of $155 billion, were in RTC conservatorship and the Office of Thrift Supervision had designated an additional 244 thrifts with $162 billion of assets as likely to be placed in RTC conservatorship. The Office of Thrift Supervision recognized still 350 more thrifts, with assets of $165 billion, as "troubled" and in some danger of failure. Although the average loss per institution will likely decline as the RTC continues its work of closing failed institutions, the RTC's future costs will exceed its costs to date.

This Act would increase the RTC's permanent funding by $57 billion, bringing the total Congress has provided in such funding to $107 billion. Of that amount, the Administration anticipates the RTC will need $90 billion to pay for deposit insurance losses and the remainder to finance a portion of what the Administration

[4] Figures are preliminary RTC data and may not add to totals due to rounding.

projects will be an asset portfolio of $110 billion. The table below details the RTC's spending of permanent funding and temporary working capital through September 30, 1990, and projected spending in FY 1991.

	Permanent losses	Temporary working capital	Total
Total spending expected by Sept. 30, 1991	90	110–115	200–205
Less total spent as of Sept. 30, 1990	29.5	45.6	75.1
Expected spending in fiscal year 1991	60.5	64.4–69.4	124.4–129.9

As the table indicates, the Administration expects to spend $60 billion on permanent deposit insurance losses and roughly $65 billion in working capital to fund temporary asset acquisition in FY 1991. The projections of FY 1991 spending in the table somewhat exceed those used in the Budget Summit and in the 1991 Budget Resolution because the Administration expects to make up shortfalls in RTC spending for the final quarter of FY 1990 in FY 1991.

These projections of FY 1991 spending assume the RTC will step up the pace of closing failed savings and loans. Over the past 6 months, spending on permanent losses has occurred at an annual rate of $48 billion, while working capital has been used at a $57 billion annual rate.

If the Administration has correctly estimated the RTC's ultimate losses at $89–132 billion in present value terms, the RTC's funding needs will decrease after FY 1991. Under the Administration's projections, the projected expenditure of $90 billion on permanent losses by the end of FY 1991 would leave, in present value terms, at most $42 billion in permanent losses to be financed in FY 1992 and years thereafter.

WORKING CAPITAL BORROWING AUTHORITY

The Act perpetuates authority conferred upon the RTC by FIRREA to borrow funds for temporary working capital, along with existing limitations on that borrowing authority. The difference between working capital and funds provided for permanent deposit insurance losses is important: the RTC must repay working capital borrowings by selling the assets of the failed savings and loans it closes. Through October 1, the RTC has borrowed $48.5 billion in temporary working capital, all of it through the Federal Financing Bank (FFB). Because the FFB obtains its funds from the Treasury, borrowing through the FFB enables the RTC to obtain the working capital it needs at the lowest possible interest cost.

FUNDING TO REDUCE THE COST OF 1988 DEALS

FIRREA required the RTC to review and analyze the terms on which the FSLIC resolved savings and loan failures between January 1, 1988, and FIRREA's enactment in August, 1989. FIRREA further requires the RTC to exercise any options it may have to modify, renegotiate, or restructure contractual obligations of the FSLIC arising from those resolutions wherever doing so can yield net savings to the Federal government. The Act authorizes the

RTC to expend such sums as may be necessary to achieve net savings in this manner.

Pursuant to FIRREA's requirements, the RTC issued a report on these contracts on September 18, 1990. Testifying before the Committee on that report, RTC Chairman William Seidman indicated that an up-front expenditure of $18–20 billion would enable the Federal Government to save $3–4 billion over the term of these contracts. Roughly half of the up-front expenditure would be used to refinance notes issued by the FSLIC, enabling the Federal government to save interest expenses. Because the FSLIC's notes were scored as outlays when issued, this refinancing involves no additional outlays.

The balance of these funds would be used primarily to repurchase assets now covered by yield maintenance and capital loss agreements. Under such agreements, the FSLIC guaranteed the acquirers of covered assets that the assets would yield earnings at least equal to what the acquirers earn on other assets. The FSLIC further guaranteed acquirers that it would make them whole for any amounts by which proceeds from sales of covered assets fell short of the book values of such assets. These contractual terms have obligated the Federal government to make high annual payments to those who acquired failed thrift institutions from the FSLIC in 1988 and 1989. By enabling the RTC to repurchase such assets, the Act would significantly reduce those annual payments in the future.

REGULATORY IMPACT STATEMENT

In compliance with paragraph 11(b) of rule XXVI of the Standing Rules of the Senate, the Committee makes the following statement regarding the regulatory impact of the bill. The bill provides funding to continue an existing program to meet prior Federal Government financial obligations. Any regulatory impact will be only incidental to the need to make required payments.

CHANGES IN EXISTING LAW

In the opinion of the Committee, it is necessary to dispense with the requirements of section 12 of rule XXVI of the Standing Rules of the Senate in order to expedite the business of the Senate.

COST OF THE LEGISLATION

The Committee has requested a cost estimate of this legislation under the provisions of Section 403 of the Congressional Budget Act of 1974. The cost estimate of the Congressional Budget Office appears below:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, October 17, 1990.

Hon. DONALD W. RIEGLE, Jr.,
Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the attached cost estimate for the Resolution Trust Corporation Funding Act of 1990.

If you wish further details on this estimate, we will be pleased to provide them.

Sincerely,

ROBERT D. REISCHAUER, *Director.*

CONGRESSIONAL BUDGET OFFICE—COST ESTIMATE

1. Bill number: Not yet Assigned.
2. Bill title: Resolution Trust Corporation Funding Act of 1990.
3. Bill status: As ordered reported by the Senate Committee on Banking, Housing, and Urban Affairs, October 12, 1990.
4. Bill purpose: This bill would provide $57 billion to the Resolution Trust Corporation (RTC) to cover losses incurred in resolving failed thrifts and to pay for administrative costs. It also would allow the RTC to borrow from the Federal Financing Bank (FFB) up to 85 percent of the value of its noncash assets, plus the amount of its cash and unused loss funds. In addition, Section 2 would authorize the Secretary of the Treasury to make available to the RTC such sums as may be necessary to exercise options relating to obligations incurred by the Federal Savings and Loan Insurance Corporation (FSLIC) Resolution Fund.
5. Estimated cost to the Federal Government:

[By fiscal year, in billions of dollars]

	1991	1992	1993	1994	1995
Estimated budget authority	79	19			
Estimated outlays	62	19*	−18	−13	−7

The impact of this bill would fall within budget functions 370 and 900.

Basis of estimate: The financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) authorized the RTC to incur losses of up to $50 billion in closing or selling hundreds of insolvent savings and loans. The RTC also has authority to borrow from the FFB for working capital to finance the purchase of assets until they can be sold.

The RTC is expected to use nearly all of the $50 billion provided by FIRREA by early in fiscal year 1991. If no additional resources are provided, the RTC will have to cease its case resolution activity and its 1991 outlays will total, by CBO estimates, about $8 billion. This bill would authorize the RTC to cover additional losses of up to $57 billion, which would permit the agency to continue resolving insolvent thrifts at least through the end of fiscal year 1991. According to the Treasury Department, about $40 billion of the $57 billion would be used to cover losses in 1991, and the remainder would be used to provide the necessary reserves to cover working capital borrowings from the FFB.

Based on the assumptions underlying the 1991 budget resolution, CBO projects that RTC's 1991 outlays under this bill would total about $70 billion, including spending financed by borrowing from the FFB. This represents an increase of $62 billion over CBO's summer baseline estimate of $8 billion. These spending estimates

are highly uncertain, however. Depending on the pace of resolutions, the type of transactions, and the extent of the losses, these amounts could be higher or lower by billions of dollars.

Net additional outlays for 1992 are projected to be $19 billion, reflecting RTC's use of the remaining spending authority authorized by this bill. The outlays resulting from this bill will be negative in 1993 and subsequent years, as assets acquired in 1991 and 1992 are sold. In the event that additional funding is provided after 1991, as is likely to be necessary, outlays in subsequent years would be greater.

Section 2 of the bill reaffirms the authority of the FDIC to modify, renegotiate, restructure, or exercise options available under certain 1988 agreements. Expenditures for these purposes would be made from the FSLIC Resolution Fund. Because the FDIC could exercise this authority under current law, no impact of this provision is included in the cost estimate table above. CBO currently estimates that FSLIC Resolution Fund outlays are likely to be about $10 billion in 1991, in addition to note repayments of another $10 billion, which do not add to the deficit.

6. Estimated cost to State and local governments: None.

7. Estimate comparison: None.

8. Previous CBO estimate: None.

9. Estimate prepared by: Mary Maginniss (226–2860).

10. Estimate approved by: C. G. Nuckols for James L. Blum, Assistant Director for Budget Analysis.

ADDITIONAL VIEWS OF MR. KERRY

I cannot support the Administration's request for this extraordinarily large amount of money until Secretary Brady provides a detailed explanation of why a doubling of funding for the S and L bailout is both necessary and sufficient.

Secretary Brady appeared before the Banking Committee on May 23rd of this year and indicated that the RTC would need between $39 and 82 billion in addition to amounts provided by FIRREA. Six months later, on October 10, he wrote a two page letter to the Committee, indicating that the RTC will need $57 billion. I do not feel satisfied that the Secretary has fully explained this request in light of his testimony last May.

Part of the problem is that since the August recess Secretary Brady has refused to testify before the Senate or the House Banking Committees. Undersecretary Glauber did testify before the Senate Banking Committee on September 26 on an unrelated banking issue. At that time Mr. Glauber was asked about the Administration's request and provided only vague answers to questions related to the RTC's funding request.

No new funds should be voted for the Savings and loan bailout until we know exactly why the funds are needed, how they will be spent, how the costs have been calculated, and why the estimates have varied so wildly from month to month.

To do otherwise I believe is to invite the skepticism of the American public that the Congress is not concerned with public debate and open consideration of how their taxdollars will be spent.

The RTC is already the exception to the rule in terms of its funding because that funding is on budget, but exempt from Graham-Rudman's deficit targets. If Congress approves this funding request, the RTC will have broken another rule: In this period of limited resources, every agency of the government must justify the need for funding.

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